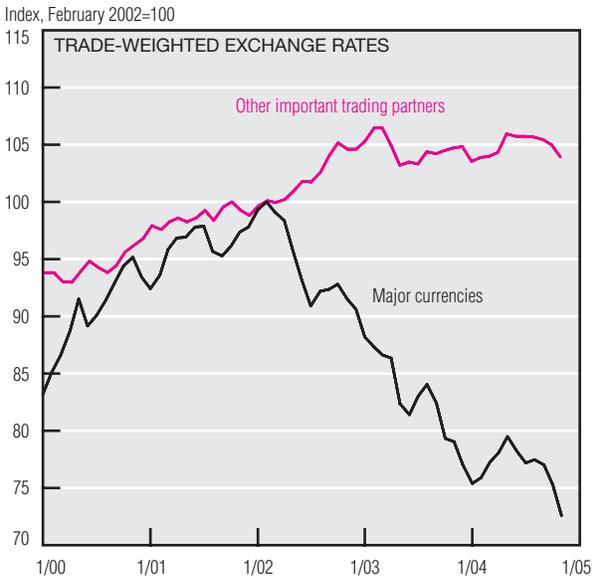
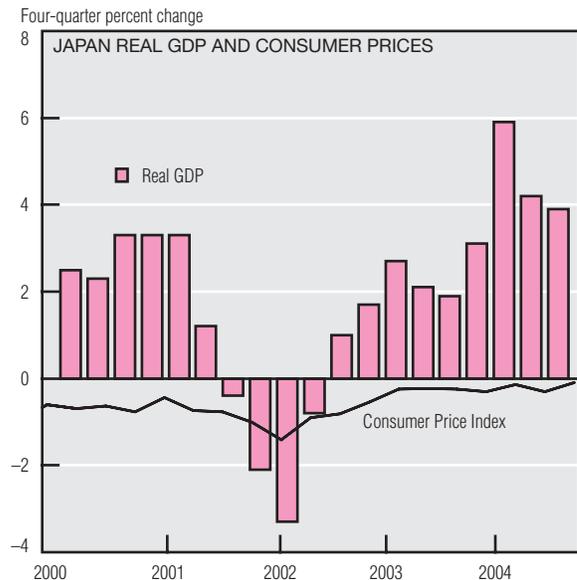
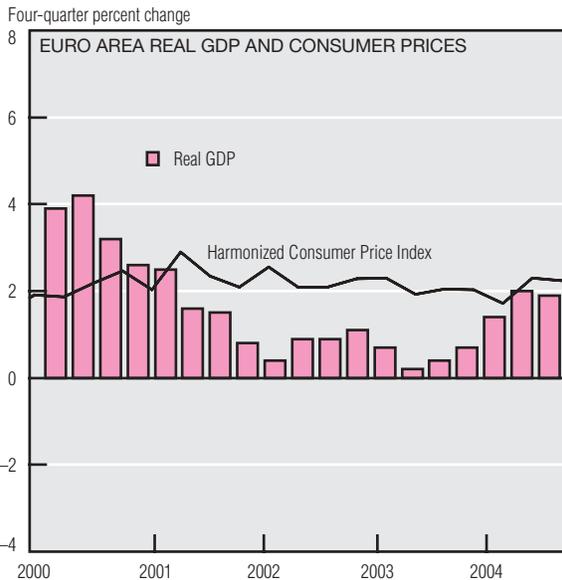


Monetary Policy and the Dollar's Decline



Dollar Exchange Rate Movements^a

	Percent change, February 27, 2002— November 19, 2004
Canada dollar	-25.8
Euro area euro	-33.8
Japan yen	-23.6
Mexico peso	25.0
U.K. pound	-23.8



a. Percent change from peak in trade-weighted dollar. Negative sign indicates a dollar depreciation. Positive sign indicates a dollar appreciation.
 SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis; Board of Governors of the Federal Reserve System, "Foreign Exchange Rates," *Federal Reserve Statistical Releases*, H.10; and Bloomberg Financial Information Services.

Third-quarter GDP growth in the euro area and Japan came in lower than analysts had anticipated, prompting many foreign policymakers to complain that the dollar's renewed depreciation poses a major downside risk to their countries' future economic growth. Dollar depreciation shifts worldwide demand toward U.S. goods and services by raising the dollar price of foreign items and lowering the foreign-currency price of U.S. products. What can policymakers do?

The European Central Bank and the Bank of Japan recently focused on

providing sufficient liquidity to accommodate economic growth. The Federal Reserve System, on the other hand, has moved since midyear to reduce the accommodative stance of monetary policy. A further move by each of the three parties in its present direction would seem consistent with slowing the dollar's recent descent and promoting its individual business cycle objective.

Ardently pursuing a weaker dollar, on the other hand, could eventually put each country's inflation objective at risk. The problem is not so great

in Japan, where prices continue to drop, or in the U.S., where inflation, though low, has recently been on an uptick. In Europe, however, inflation is already at the European Central Bank's target limit. Further easing to offset the dollar's appreciation might eventually interfere with the Bank's inflation objective. In that case, any competitive trade advantage gained by offsetting the dollar's depreciation might be lost through higher prices.